

Customary business practice regarding pawnshops notifying in writing the pledgor before sale of collateral



Article 14 (3) of the Republic of Armenia Law on Financial System Mediator establishes that in making a decision Mediator shall be based not only on the requirements of the Armenian legislation but also on the rules of business conduct and ethics, and customary business rules. In response to the request of the Union of Pawnshops as well as for continued viability of operations of the Financial System Mediator and in consideration of the possibility to apply a customary business practice, the Office of Mediator sent, on June 16th of this year, a circular letter to all banks operating in Armenia and requested them to provide opinion with regard to the matters, as follows:

Article 249(2) of the Civil Code establishes that two months after the notice of seizure has been sent to the debtor, the pledgee shall be entitled to market, through direct sale or public auction, the item of collateral on behalf of the pledgor, unless otherwise agreed upon between the pledger and the pledgee. The Office wished to know, where loans provided by a pawnshop are involved, whether the item of collateral is sold through direct sale or public auction. If the item of collateral is sold through direct sale what mechanism for implementation is in place?

There were some pawnshops which voiced opinion that the two-month period as referred to in Article 249(2) of the Civil Code does not apply to the collateral of this kind and, where loans provided by a pawnshop are involved, the pawnshop shall market the property without adhering to the above said rule. Pawnshops argue that pursuant to customary business practices they are governed by the requirement laid down in Article 255(7) of the Civil Code when marketing the item of collateral. It should be noted that in most cases the complaints filed against pawnshops were relating to this matter. To identify Customary Business Practice, the Office has requested banks to propose their view on the matter and describe which internal rules and procedures they had in place.

Explanations and clarifications issued by banks with regard to the matter as well as discussion with reliable lawyers have driven us to a conclusion, as follows:

a) In addition to general rule on sale of the item of collateral, as established under Article 249 of the Civil Code, there is a special provision under Article 255(7) of the Civil Code pertaining to the sale of the item of collateral by pawnshops. That article says that failure to repay the loan which is secured by collateral in a specified timeframe shall prompt the pawnshop to market that collateral through public auction. This provision infers that the contract entered into between the pledgor and the pawnshop may provide for only one way of sale of collateral, i.e. public auctions, since this rule is imperative and not subject to modification.

b) At the same time though, Article 255 of the Civil Code has not provided for special timing and procedure on marketing the item of collateral, which is why industry participants remain adherent to the application of the general rule specified in Article 249(2) 3 of the Civil Code under the third paragraph, saying that two months after the notice of seizure has been sent to the debtor, the pledgee shall be entitled, under the law, to market, through direct sale or public auction, the item of collateral on behalf of the pledgor, by adhering to the requirement laid down in Article 195 hereinabove, unless otherwise agreed upon between the pledgor and the pledgee for another procedure of sale of the collateral. The last paragraph is of a dispositive nature meaning that the contract entered into between the pledgor and the pledgee may decide on timing other than the established two-month period for the sale of collateral, after notifying the pledgor, which would not run into conflict with civic legislation.

As the customary business practice is presented we are hopeful that what we identified and clarified with regard to such practice will help pawnshops in maintaining lawfulness and effectiveness of their operations and will prevent them from infringement of consumer rights.